

Streamlined Sales and Use Tax Agreement: What Does It Mean for Virginia's Technology Future?

**Virginia Remote Sales Tax
Collection Study Commission
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Technology is the Economic Engine of Virginia

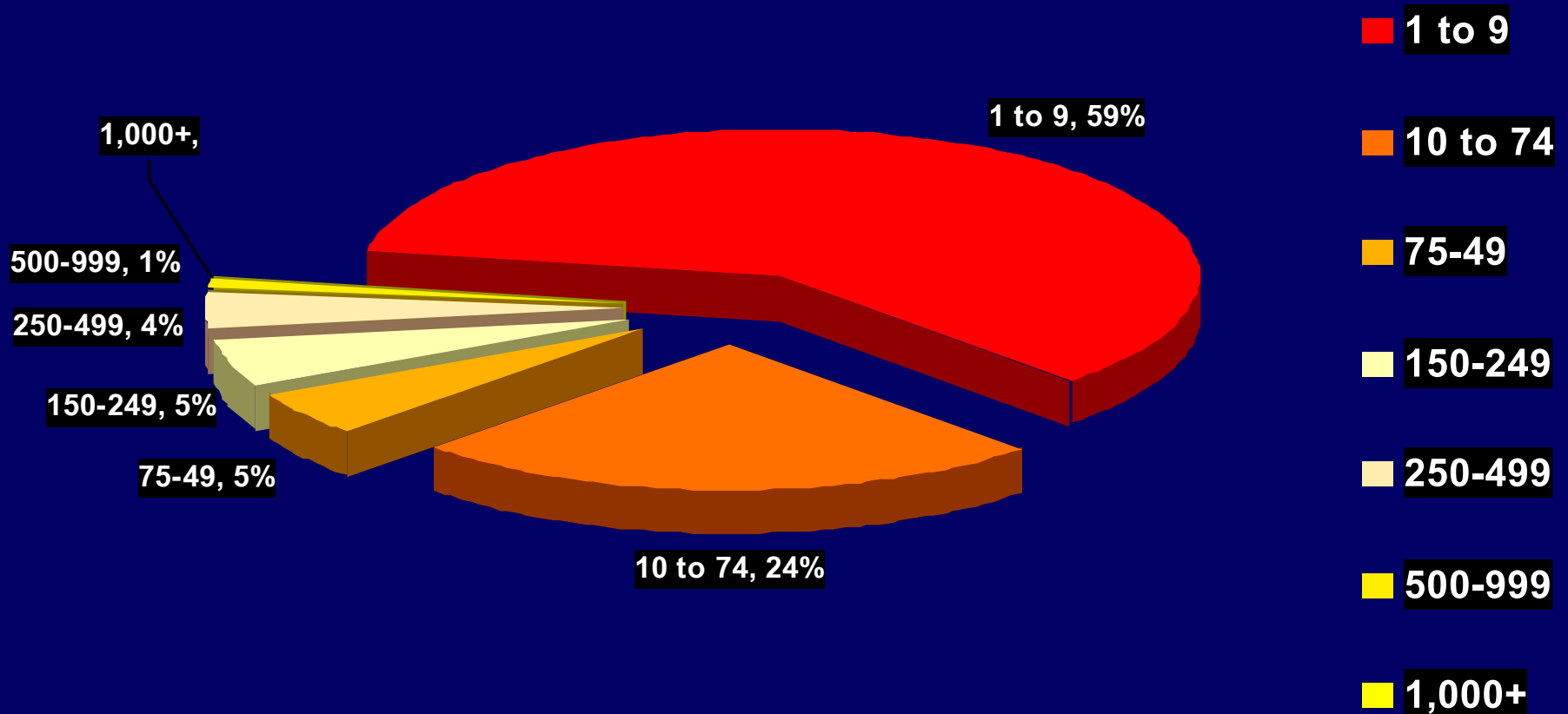
Virginia's Diverse Technology Industry Spans All Sectors Including:

- Software
- Information Technology
- Internet
- ISPs
- ASPs
- Telecommunications
- Biotechnology
- Bioinformatics
- Aerospace
- Nanotechnology
- Service Providers



Technology is the Economic Engine of Virginia

Size of NVTC Member Companies
By Number of Employees



Technology is the Economic Engine of Virginia

By The Numbers

- Technology employment: 424,702 (3Q, 2003)
- 2nd highest employment rate in the nation (March 2003-March 2004)
- More than 20% of Virginia's payroll is in high tech sector
- Wages and Salaries: \$7,010,385, 000 (3Q, 2003)
 - VA Average tech wage : \$66,026 (3Q, 2003)
 - VA Average wage: \$37, 713 (3Q, 2003)
- Northern Virginia:
 - Over 60% of Virginia's tech businesses and workers
 - 4400 IT companies in Fairfax County alone
 - Creates 2 of every 3 jobs in VA
 - Lowest unemployment in VA at 2.2%
 - NoVa's tech driven wages/salaries ready to grow 9% this year, 9% in 2005

Sources:

- ♦ Virginia Economic Trends, 2nd Quarter 2004 Report
- ♦ Fairfax County EDA

Technology is the Economic Engine of Virginia

Virginia Ranks At The Top Nationally

- #1 - Technology Concentration (degree to which state economy is fueled by tech sector)
- #1 - New technology companies formed (as % of all new companies established)
- #1 - Number of computer specialists per 10,000 workers
- #1 - Computer and Information Systems Experts
- #2 - Technology company payroll (as % of total)
- #2 - Net new technology company formations
- #2 - Computer systems design and related services employment
- #4 - Technology and Science Workforce (as % of total state employment)
- #5 - Internet services employment

Sources:

- ♦ State Science and Technology Indicators: Fourth Edition, US Dept. of Commerce, 2004
- ♦ Milken Institute, 2004 State Technology and Science Index
- ♦ AEA: Cyberstates 2003

Technology is the Economic Engine of Virginia

Virginia's Technology Assets Drive Success

- Highly Educated/ Highly Skilled Workforce
- 12 Major Federal Research Labs, Agencies, Centers
- 7 Public Research Universities (2 Rank Top Ten for Education)
- Nationally Recognized Community College System
- 10 Regional Technology Councils
- Strong Technology Policy Framework:
 - Internet governance and e-government
 - Promotion of entrepreneurship
 - Important tax policy initiatives
 - Strong economic development policies

Technology is the Economic Engine of Virginia

Good Public Policy Decisions Drive Success

- Virginia Policy Efforts Have Focused On:
 - ♦ Attracting technology businesses, jobs to VA
 - IT among 9 sectors targeted by VEDP
 - ♦ Making Internet, technology easier, more accessible for business and consumers
 - ♦ Encouraging traditional business to utilize technology/online transactions, to gain benefits of larger economy:
 - Increased speed
 - Accuracy
 - Automated processes
 - Convenience
 - Better Bottom line

Technology is the Economic Engine of Virginia

Good Public Policy Decisions Drive Success

- Low Corporate Tax Structure
- First Cabinet-level Secretary of Technology
- Important Technology Policy Initiatives (Digital Signatures, UCITA, UETA)
- State-level Moratorium on Internet access taxes
- Targeted Tax Incentives (Biotechnology, ISPs, Venture Capital/Angel Investors, Software)
- Aggressive Anti-Spam and Computer Crimes Laws (Long Arm Statute, Encryption)
- Declaratory Judgment for Sales Tax Obligations
- Virginia's Center for Innovative Technology (CIT)
- Joint Commission on Technology and Science (JCOTS)

SSUTA: A Significant Change In Course

5 Main Tech Industry Concerns

1. Work In Progress, Little To Evaluate
2. Expanding Tax Collection Responsibilities To 30 Plus States Would Exact Inordinate Compliance Burden On Virginia Technology Businesses And On E-commerce
3. Scope Of SSUTA Would Extend Beyond E-retailers
4. Costs And Benefits To Virginia Are Still Unknown
5. Virginia's Comparative Advantage In Growing And Attracting Technology Companies Would Erode, Nationally And Internationally



Main Concerns:

SSUTA Is A Work In Progress

- There Is No National Consensus
- Terms Still Being Written, Changed
 - “SSTP Agreement is still undergoing changes and it is impossible to predict the provisions of the final Document”
 - Kenneth W. Thorson , Virginia’s Tax Commissioner-July 15, 2003
- There Is No National Consensus
- 20 states → Congressional Involvement→
Congressional Mandates?
 1. Small Business Exemption (Under \$5 million)?
 2. Shifting Governance Body/Role of Federal Courts
 3. Seller Compensation? (i.e. Administration, collection and remittance PLUS “all tax processing costs”?)



There Is No Consensus: Example - Sourcing

- Section 102: Fundamental Purpose
 - ♦ The Agreement focuses on improving sales and use tax administration systems for all sellers and for all types of commerce through all of the following:
 - ♦ F. Uniform sourcing rules for all taxable transactions.
(SSUTA, November 12, 2002)

There is No Consensus: Example - Sourcing

◆ “Sourcing is a material part of the SSTA. Nonconformity with SSTA sourcing will prevent Washington from becoming a member state of the SSTA and its governing board. As a result, Washington will not enjoy the benefits of the SSTA”

- Washington State Streamlined Sales and Use Tax Agreement Sourcing Study, December 2003.

◆ “The following criteria are the minimum simplification requirements for the Agreement:

- (3) Uniform rules for sourcing and attributing transactions to particular taxing jurisdictions”

- S.1736. Oct. 15, 2003.

There is No Consensus: Example- Sourcing

- “Adopt the Streamlined Sales Tax statute (without the sourcing rules), effective July 1, 2006.”
 - A Commonwealth of Opportunity Plan, Governor Mark Warner
- “The one area where Virginia is not conforming to the agreement is related to the sourcing for purposes of the local sales tax. This is being done to preserve the status quo for Virginia dealers and limit the shifting of local sales tax revenue. Under the terms of the agreement, all sales, both interstate and intrastate, would be sourced to the locality where the goods are destined. This would require Virginia to source the 1 penny local sales tax to the locality of use or delivery, instead of the locality of the sale. Making this conforming change would impose significant burdens on in-state dealers and shift revenue between localities. Several states that have changed their local sourcing rules have encountered significant problems and resistance from in-state dealers in trying to implement a change in local sourcing. Ohio and Kansas, which adopted the “destination” sourcing rules, have both delayed implementation of this change due to concerns from local vendors. Texas and Washington have adopted the other requirements of the SSTP agreement, without the sourcing rules. This bill would follow the approach taken by Texas and Washington and adopt the agreement terms without the sourcing change. Because this bill has an effective date of July 1, 2006, Virginia would have time to determine whether the issue can be renegotiated among the states.”
 - VA Dept of Taxation 2004 Fiscal Impact Statement: SB 514 (Hanger).

Main Concerns:

Expanding Tax Collection Responsibilities To 30 Plus States Would Exact Inordinate Compliance Burden On Virginia Technology Businesses And On E-Commerce



SSUTA: A Significant Change in Course

- Current Environment
 - ♦ Virginia technology businesses, like traditional businesses, must collect sales taxes, regardless of the medium by which transaction occurs.
 - ♦ Virginia technology businesses, like traditional businesses, responsible for administering one sales tax system, one sales tax rate, one audit, one set of rules.
 - ♦ Virginia consumers and businesses required to remit use tax . One use tax system, one audit, one use tax rate, one set of rules.



SSUTA: A Significant Change In Course

- Proposed Environment
 - ♦ Virginia technology businesses, like traditional businesses, still must collect sales tax, regardless of the medium by which that transaction occurs.
 - ♦ Use tax collection responsibility shifts from purchaser to out-of-state seller.
 - ♦ Virginia technology businesses, unlike traditional businesses, must collect and remit sales and use taxes for every state in which they have a customer. Multiple sales tax systems, multiple sales tax rates, potential for multiple audits, multiple rules.



What is the Cost SSUTA Imposes On Business?

- 20+ States As Signatories, No Due Diligence Study
- Plug-in, Turnkey Solution Not Always Option
- Expensive To Retool Backend Staff/Systems (Returns, Partial Sales, Exchanges, Credits)
- Companies With No Obligation In VA Would Have To Pay For Back End Systems And Infrastructure To Collect In Other States (Internet Services Companies, Software Companies)

What is the Opportunity Cost SSUTA Imposes On Business?

- Disproportionate burden on small businesses
 - ♦ Barrier to entry, disincentive to increase market share
 - ♦ Counters benefits of e-commerce: speed, convenience, accuracy, productivity and expanded markets

Level Playing Field? Different Playing Field!

Another Look At Sourcing

- ◆ Big Burden:
 - In-state dealers: main street businesses resist SSUTA Uniform Sourcing Rules requiring them to track and account for good shipped to various jurisdictions within Virginia.
- ◆ Bigger Burden:
 - SSUTA would require technology businesses to account for good shipped to jurisdictions nationwide (potentially 40-7000 jurisdictions).
- ◆ “The one area where Virginia is not conforming to the agreement is related to the sourcing for purposes of the local sales tax. This is being done to preserve the status quo for Virginia dealers and limit the shifting of local sales tax revenue. Under the terms of the agreement, all sales, both interstate and intrastate, would be sourced to the locality where the goods are destined. This would require Virginia to source the 1 penny local sales tax to the locality of use or delivery, instead of the locality of the sale. Making this conforming change would impose significant burdens on in-state dealers and shift revenue between localities. Several states that have changed their local sourcing rules have encountered significant problems and resistance from in-state dealers in trying to implement a change in local sourcing. Ohio and Kansas, which adopted the “destination” sourcing rules, have both delayed implementation of this change due to concerns from local vendors. Texas and Washington have adopted the other requirements of the SSTP agreement, without the sourcing rules. This bill would follow the approach taken by Texas and Washington and adopt the agreement terms without the sourcing change. Because this bill has an effective date of July 1, 2006, Virginia would have time to determine whether the issue can be renegotiated among the states.”
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Main Concerns:

The Scope of SSUTA Would Extend Beyond E-Retailers / ".coms"

- Will Virginia companies be forced to collect and remit sales tax on services?
- Sales Tax On Professional Services: CT, HI, SD, TX...
In some instances "data processing" and "information services".
- South Dakota taxes Internet access service, domain fees, design or placement of ads on the Internet, web hosting services, engineering services.
 - Internet Registrars : Internet domain fees?
 - Technology Service Providers: Data Processing, online content, search engines?
 - ISPs: Internet Services, Internet Access Taxes?
 - ASPs, Data Centers: Web Hosting Services?
 - Computer and Software Engineering Firms: engineering services?



Main Concerns:

The Scope of SSUTA Would Extend Beyond E-Retailers / “.coms”

- Will Virginia companies have to collect and remit sales tax on electronically delivered software or computer information?
- VA Law- Expressly exempts the electronic delivery of software, data, content and other information services via the Internet from the Commonwealth's sales and use tax.
 - ♦ Chapter 607, 2004 VA Acts of Assembly; State Tax Commissioner Rulings (97-405 and 02-111)
- Kentucky Law- Beginning July 1, 2004, prewritten software and other tangible personal property such as books and movies that are downloaded electronically to Kentucky customers will be taxable on the same basis as comparable products delivered by mail or purchased over the counter.
 - ♦ Kentucky KRS 139.60

Main Concerns: Costs and Benefits To Virginia Are Still Unknown

Question: How much would Virginia really gain in sales tax revenues?

Answer: Unknown

- We know that:
 - ♦ Virginia law requires those who make purchases from out-of-state sellers to remit a use tax to the Commonwealth on all purchases over \$100.
 - ♦ 90% of remote sales in Virginia are B2B and the payment of use tax pursuant to those transactions is enforced through state tax audits and voluntary reporting (\$251 million was collected in 1999).
 - ♦ Forrester reports that B2B will be increasing to 95% by 2011
 - ♦ 10% of remote sales in Virginia are B2C, decreasing to 5% by 2011
 - ♦ Consumer use tax compliance is low



Main Concerns:

Costs and Benefits To Virginia Are Still Unknown

Question: How much would Virginia really gain in sales tax revenues?

Answer: Unknown

- Forrester also tells us:
 - ♦ “Online sales now closely mirror offline sales: With the exception of Amazon.com and eBay, the majority of online sales are closed by the same retailers that dominate offline sales.”
 - ♦ “Who are these multichannel retailers? They are the same retailers that succeed offline-Target, Wal-Mart and Sears, for example.”
 - ♦ “Sales from multichannel retailers accounted for 72% of online sales in 2002 and 75% in 2003.”
 - ♦ “Of those that sell online, 94% of the top 100 retailers collect sales tax online in states in which they have a nexus.”

Source: The Growth of Multichannel Retailing, Forrester Research Inc, 2004



Main Concerns:

Costs and Benefits To Virginia Are Still Unknown

Question: How much would Virginia really gain in sales tax revenues?

Answer: Unknown

- National numbers/estimates are all over the place:
 - ♦ 2003 US B2C E-commerce Data
 - ♦ (Old) University of Tennessee \$127.4 billion
 - ♦ (New) University of Tennessee \$92 billion
 - ♦ Forrester Research \$114 billion
 - ♦ Jupiter Research \$52 billion
 - ♦ US Department of Commerce \$55 billion



Main Concerns:

Costs and Benefits To Virginia Are Still Unknown

Question: How much would Virginia really gain in sales tax revenues?

Answer: Unknown

- Virginia numbers/estimates are all over the place:
 - ♦ The University of Tennessee *Mea Culpa*
 - Overstated 2003 Lost Revenue Projections By 44%
 - Revised Downward From \$458 million to \$256 million.
 - ♦ “The experience of the last several years indicates that e-commerce has been a less robust channel for transacting goods and services than was anticipated when we prepared the earlier estimates. The findings provided here are based on lower estimates of e-commerce, and the result is a smaller revenue loss than we previously indicated. Our loss estimates are also lower because many more vendors have begun to collect sales and use taxes on their remote sales.”
 - State and Local Sales Tax Revenue Losses from E-Commerce: Estimates as of July 2004, University of Tennessee, July 2004



The Virginia Equation: Factors To Consider

- Net-out B2B Compliance In VA Greater Than 73%
- Net-out 6% Of Retailers In Violation Of Current Law
- Net-out Small Business Exemption/\$5 Million Threshold?
- Net-out Seller Compensation, if Any?
- Net-out Va Tax Exemptions (Downloaded Software, Services)
- Net-out \$100 Aggregate Virginia Use Tax Threshold (Assuming No Tax Increase On Consumers)

What is the impact of the Agreement on the competitiveness of Virginia and Virginia businesses in the global economy?

- **Will states lose flexibility in shaping tax policy to grow and attract important industries?**
- **Is Virginia “disarming” its competitive advantage vis a vis non-technology states?**
- **Does Virginia’s tax exemption for downloaded software provide a benefit when Virginia companies must still collect for Kentucky? Internet Services companies? Data processing services companies?**



What is the impact of the Agreement on the competitiveness of Virginia and Virginia businesses in the global economy?

- **Are the states collectively forcing technology companies to grow and expand elsewhere?**
- **Are costs and burdens competitive with other countries?**
- **Does SSUTA encourage entrepreneurs to locate offshore? Will the next “Amazon” Locate Offshore?**



What is the impact of the Agreement on the competitiveness of Virginia and Virginia businesses in the global economy?

The Competition: Software Technology Parks of India

- IT software Industry is exempted by the Andhra Pradesh Pollution Control Act.
- No sales Tax on computer software.
- IT software industry is exempted from zoning regulations for the purpose of location.
- Government agrees in principle to self- certification / exemption as far as possible for the IT Software industry from the provisions of the following Acts / Regulations: Factories Act; Employment Exchange (Notification of Vacancies Act); Payment of Wages Act ; Minimum Wages Act ; Contract Labour (Regulation and Abolition) Act; Workmen's Compensation Act; Andhra Pradesh Shops and Establishments Act; and Employees State Insurance Act.
- Rebate in the cost of land allotted to an IT industry at Rs. 20,000/- per job created subject to certain conditions.
- For IT infrastructure companies establishing facilities on private /APIIC /Government lands, concessions will be in the form of rebate on registration and transfer of property charges and exemption from stamp duty on a reducing scale for sale/ lease of built-up space to the IT industry.
- Investment subsidy for new IT hardware and software industries at 20%of the fixed capital investment but not exceeding Rs 20,00Lakhs.
- Special incentives for Mega Projects/Pioneering Projects.

Reject SSUTA As A Mandate

- Embrace SSUTA Goals: Simplification, Common Definitions
- Seek To Bolster Virginia Revenues:
 - ♦ Enforce Tax Laws:
 - 94% Of The Top 100 Retailers Collect Sales Tax Online In States In Which They Have Nexus: 100% Goal
 - Implement Stronger Enforcement For B2B Use Tax Remittance: 100% Goal
 - Increase Consumer Use Tax Obligation Awareness, Begin Enforcement
 - ♦ Establish Nexus Through Aggressive Economic Development
 - Target Large Remote Sellers For Relocation, Expansion In VA



Reject SSUTA As A Mandate

- Rework SSUTA As Permissive, Voluntary
- Allow Interested States To Utilize Interstate Compact
- Establish Virginia As Preferred Location For Tech Companies
- Look To Other States As Models:
 - ◆ Delaware / Business Incorporations
 - ◆ North Carolina / Banks
 - ◆ South Dakota / Credit Card Companies
- Virginia's Congressional Delegation Well Positioned To Protect Interests Of Virginia's Technology Economy
- Natural Allies: States Without Sales Tax (New Hampshire) And States With Strong And Diverse Technology Base (Colorado)



Thank You

